BONDING FOR OPEB AND PENSION LIABILITIES – OAKLAND COUNTY EXPERIENCE (AN UPDATE)

Robert Daddow, Deputy County Executive
248 / 858-1650
daddowr@oakgov.com

and

Laurie Van Pelt, DMB Director
248 / 858-2163
vanpeltl@oakgov.com

OUTLINE - BUSINESS ISSUES AND PROPOSED RESOLUTIONS

- Unfunded pension and retirees' healthcare (OPEB) liabilities are substantial and growing in many local units and a commitment many local units of government may not be able to fulfill in the coming years.
- Bonding could be an alternative for the financing of unfunded actuarial accrued liabilities for many local units if properly structured.
- Oakland County's experience with debt issues to cover unfunded liabilities for OPEB liabilities.
- Development of an OPEB pool on behalf of the local units of government – new legislation to be considered.

Oakland County
Michigan

BONDING FOR PENSION AND OPEB LIABILITIES

- Michigan recognized the OPEB issue and is now allowing local units to issue bonds in mitigating local issues.
- Michigan's P.A. 329 of 2012 considered several restrictions:
  - Required the defined benefit plans to be closed (with the new hires covered by a defined contribution plan). Defined contribution plans must continue while the debt is outstanding.
  - Fiscal and program plan to be submitted to State Treasury for approval and required to demonstrate control over future pension and / or OPEB costs (could become a covenant to the bond issue).
  - Minimum bond rating required of AA.
  - Ability to issue pension and OPEB bonds ends on Dec. 31, 2014 (sunset date).

Oakland County
Michigan

Oakland County OPEB Funding

- Issued certificates of participation (COPS) on July 31, 2007.
- Sizing of the trust certificates (in millions):

– Actuarial accrued liabilities	$ 829.7
– Actuarial assets	(303.1)
Unfunded actuarial accrued liabilities	526.6
– 2007 and 2008 ARC short-fall	25.9 (1)
– Issuance costs / prepaid interest	4.5
Total amount borrowed	**$557.0**

(1) Financial impact of actuarial assumptions arising from the closing of the OPEB plan to new hires effective Jan. 1, 2006.

(2) At the time of the trust certificate borrowing the County's OPEB plan was 100% funded between two trust funds.

Oakland County
Michigan

ORIGINAL OPEB SAVINGS (IN 2007)

- In 2007, $557 million of taxable Certificates of Participation (COPS) issued to be repaid over ***20 years***:
  - Annual debt service of approximately $48.5 million vs. $60.2 million ARC payment for 2008. ARC payment was increasing at that time.
  - Interest rate of 6.23% on COPS.
  - Callable after 7 years (April 1, 2014).
- Reduced funding period by 10 years (30 year amortization period to 20 years of debt service).
- **Net present value savings conservatively estimated to be no less than $100 million due, in part, to the shortening of funding period and the investment income earned between the interest paid and the long-term investment performance of the two OPEB funds.**

Oakland County
Michigan

PRELIMINARY OPEB COPS REFINANCING (3)

In millions:

VEBA market value of assets (1)	$ 779.5
IRMBT market value of assets (1)	317.2
Total assets at market value	1,096.7
Estimated actuarial accrued liabilities (AAL)	
@ Sept. 30, 2013 (2)	(940.2)
Estimated net available assets	**$156.5**

(1) *Market value* of assets as of July 31, 2013.
(2) Based on May 31, 2013 actuarial report rolled forward to September 30, 2013.
(3) Bonds issued on September 27, 2013; final financial analysis is pending.

Oakland County Michigan

USE OF AVAILABLE ASSETS

- Estimated available assets used for (in millions):

– Projected AAL at September 30, 2013	$ 940.2
– Portion of available assets used to ensure full funding	75.2
Targeted assets in VEBA – 108%	**$1,015.5**
– Debt to be called at April 1, 2014	$ 422.1
– Available assets used to reduce borrowing	(73.3)
Amount borrowed, net of $1.2M in issuance costs	**$ 348.8**
– Recap of available assets	$ 156.5
– Used for VEBA	(75.3)
– Used for reduction in borrowing	(73.3)
Initial funding in prepayment of future normal costs	**$ 7.9**

Oakland County Michigan

FY-2013 DEBT REFINANCING - RECAP

- COPS callable on April 1, 2014 - $422.1 million.
- Have issued taxable bonds ($350M) under new Michigan legislation (PA 329). COPS will be called after several additional actions are undertaken to complete the transaction.
- Formal plan was submitted and approved by the Michigan Treasury Department.
- With available assets of $7.9M and several years of debt service savings devoted to a new 'superseding' trust, Oakland County should have its normal costs PRE-funded for many decades to come.

Oakland County
Michigan

DEBT REFINANCING (Cont.)

- **Budgetary savings of approximately $13M annually** over current debt service using a 13-year term for bonds:
  - Interest rates have fallen since the COPS were issued – 3.7% overall rate for taxable debt.
  - Bonds are better understood in the market than COPS. P.A. 329 legislation passed in October 2012 facilitated this debt issue.
- A similar approach can be used for other local units of government – in their direct issuance of bonds or through a pooled arrangement (yet to be created through legislation).

Oakland County
Michigan

BONDING UNFUNDED AAL THROUGH POOLS

- Benefits:
  - Demonstrated ability to bond for actuarial accrued liabilities (AAL).
  - Feasibility costs (financial, actuarial, legal and other) can be recovered via bonding; if centralized, costs could be minimized.
  - Bundling of local units' pension / OPEB needs could facilitate the use of PA 329 and enhance debt ratings of participating units.
  - Smaller local units can spread investment, healthcare inflation and other risks over a larger pool of resources.
  - Should be credit positive; removes unfunded AAL from comprehensive annual financial report and replaces with debt.

Oakland County
Michigan

BONDING THROUGH POOLS - RISKS

- Investment risk – risk that investments decline:
  - Longer-term view versus short-term view . Perhaps a periodic assessment of the pool with the potential of a supplemental payment being required from local units, if absolutely necessary.
  - Pensions plans have faced this very issue in the past and there seems to be no public outcry involving this very issue with pensions.
  - Annuities could be offered for pension benefits, plans exist to guarantee a minimum return in the future. With larger investment pools, the cost could be minimized.
  - Development of a 'market valuation' risk pool with excess bond proceeds to protect against market declines.

Oakland County
Michigan

BONDING THROUGH POOLS - RISKS

- Healthcare inflation – moderated through the following actions:
  - Actuaries already consider inflation in assumptions – reflected in the AAL and annual required contributions.
  - Closing of OPEB plan.
  - Limiting options for healthcare.
  - Limiting (or preventing) any enhancements to the OPEB benefits once bonded.
  - Catastrophic losses could be mitigated through an insurance product.

Oakland County Michigan

CONSIDERATIONS / SUMMARY

- Involve actuary and financial advisors early in the bond discussions as the impact of the changes to the pension / OPEB plans will be substantial.
- AA bond requirement combined with long-range budgeting should be well accepted by the bond rating agencies in resolving OPEB issue (should be 'credit positive'). Could retain a AA bond rating, but include some lesser rated local units that are not currently permitted to participate.
- Substantial savings could be obtained from investment gains over bond interest payments; need to be careful in developing financial projections.
- If NO funding has previously been provided towards OPEB, it may be very difficult to financially justify the bonding unless the local unit is willing to accept additional costs in its budget

Oakland County Michigan

Q AND A

Contact Information:

Robert Daddow
daddowr@oakgov.com
(248) 858-1650

or

Laurie Van Pelt
vanpeltl@oakgov.com
(248) 858-2163